



Excise Tax Advisory

Excise Tax Advisories (ETA) are interpretive statements issued by the Department of Revenue under authority of RCW 34.05.230. ETAs explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts. They are advisory for taxpayers; however, the Department is bound by these advisories until superseded by Court action, Legislative action, rule adoption, or an amendment to or cancellation of the ETA.

NUMBER: 398.04.136 *Repealed June 17, 2000*

CONVERSION DATE: July 1, 1998

COMBINING ITEMS TO ACHIEVE A SPECIAL PURPOSE PRODUCT IS MANUFACTURING

Revised: March 1, 1993

Repealed June 17, 2000

This is a revision of an earlier ETB and clarifies when combining items will be considered manufacturing. The specific facts and circumstances surrounding each situation must be carefully examined to determine if the activity reaches the level of manufacturing or is merely a packaging or marketing activity.

The Department ruled that a person who assembled gift baskets using prepackaged foods was not a manufacturer under the specific facts of the case. In this case the taxpayer placed salmon and chocolates into a wicker basket for sale. These items were retained in their original packaging and the taxpayer did not attach its own labels to the components or the combined basket. The taxpayer also maintained an inventory for sale of the individual items and did sell these items in this manner as well as packaged baskets. The activity of combining these items into a basket under these specific circumstances did not reach the level of being a manufacturing activity.

However, the Department has ruled that under some facts and circumstances the activity of combining bulk or wrapped candies with other items of tangible personal property to achieve a special purpose product is "manufacturing" within the definition of RCW 82.04.120.

In a situation considered by the Department to be manufacturing, the taxpayer's personnel arranged, assembled, and packaged candies, toys, and other components into Easter baskets and Christmas gift packages. The taxpayer argued that this function of arranging is not a manufacturing activity. Thus, no business and occupation tax should be assessed on those products sold and shipped in interstate commerce to points outside the state.

ETBS have been made Excise Tax Advisories, and have retained their old number. Advisories with a 2 (plus three digits) are new advisories, ETBs that have been revised and readopted after review under the Department's regulatory improvement program, or advisories that have been revised and/or readopted.

To inquire about the availability of receiving this document in an alternate format for the visually impaired or language other than English, please call (360)753-3217. Teletype (TTY) users please call 1-800-451-7985.

Please direct comments to:
Department of Revenue
Legislation & Policy Division
P O Box 47467
Olympia, Washington 98504-7467
(360) 753-4161 eta@DOR.wa.gov

The Department ruled that such activities constitute manufacturing within the Washington code and rules. RCW 82.04.120 defines the term "to manufacture" as embracing all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof, a new, different or useful substance or article of tangible personal property is produced for sale. In Bornstein Sea Foods, Inc. v. State, 60 Wn.2d 169, 175 (1962), the court articulated the test for determining whether a new, different and useful article has been produced:

[W]hether a significant change has been accomplished when the end product is compared with the article before it was subjected to the process. By the end product we mean the product as it appears at the time it is sold or released by the one performing the process.

In McDonnell & McDonnell v. State, 62 Wn.2d 553, 557 (1963), the court set forth specific elements to be considered in comparing the product before and after the taxpayer completes its activities:

[C]hanges in form, quality, properties (such changes may be chemical, physical, and/or functional in nature), enhancement in value, the extent and the kind of processing involved, differences in demand, et cetera, which may be indicative of the existence of a "new, different, or useful substance."

Although the Washington courts have consistently adopted a broad definition of "manufacturing," this definition has only been applied in cases where the taxpayer's processes have caused a significant change in the product. E.g., Continental Coffee Co. v. State, 62 Wn.2d 829 (1963)(roasted, blended coffee from green coffee beans); McDonnell, 62 Wn.2d 553 (split peas from whole, dried peas); Bornstein, 60 Wn.2d 169 (fish fillet from whole fish); Stokely-Van Camp v. State, 50 Wn.2d 492 (1957)(frozen fruits and vegetables from fresh fruits and vegetables); J&J Dunbar & Co. v. State, 40 Wn.2d 763 (1952)(whiskey from raw, undrinkable whiskey).

The Department considers "manufacturing" to include the assembling of products from component parts. The manufacturing tax applies to persons located in Washington who purchase from various suppliers component parts and apply labor to assemble these parts into a new, different, or useful product. In some cases the "assembly" may consist solely of combining parts from various suppliers to create an entirely different product which is sold as a kit for assembly by the purchaser. In these situations the manufacturing tax will apply even if the person combining the parts does not completely assemble the components, but sells them as a package. For example, a person who purchases component parts from various suppliers to create a wheelbarrow, which will be sold in a "kit" or "knock-down" condition with some assembly required by purchaser, will be a manufacturer. The purchaser of the wheelbarrow will not be a "manufacturer" even though the purchaser must attach the handles and wheel.

The Department will consider various factors in determining if the person who combines various items into a single package is engaged in manufacturing. These factors include, but are not limited to:

- (1) The ingredients are purchased from various suppliers.
- (2) The person combining the ingredients attaches its own label to the product.
- (3) The ingredients are purchased in bulk and broken down into smaller sizes.
- (4) The combined product is marketed at a substantially different value from the selling price of the individual components.
- (5) The person combining the items does not sell the individual items except within the package.

Any single one of the above factors is not conclusive evidence of a manufacturing activity. However, the presence of one or more of the above factors raises a presumption that a manufacturing activity is being performed. Persons who combine items into special purpose packages should request a ruling from the Department if they are uncertain of their tax liability.